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ABSTRACT

In 1983, Channahon School District 17 in Illinois was $1.3 million in debt. Real estate taxes constituted the school district's chief source of revenue, but because the state's oil industry kept its assessed valuations below the actual value of its property through the use of experts and lawyers, the school district was denied much of its income. Thus, the school district decided to take the oil company to court. The school district hired an expert in oil refineries as a consultant and lawyers who were experts in representing local organizations. Consultants were necessary because the procedures for assessing the value of property and for challenging assessed valuations are complicated. The school district won the case. The property tax appeal board assessed the value of the property at $166 million, in opposition to the industry's assertion that the assessed valuation was $76 million. The subsequent increase in the amount paid by the oil company to the school district accounted for the school district's positive budget of $1.5 million in 1987. Four charts are included. (RG)

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ONE APPROACH TO INCREASING REVENUES FOR YOUR SCHOOL DISTRICT

(A SMALL SCHOOL DISTRICT'S SUCCESSFUL STRUGGLE)

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EA 020 035

Paper presented at the Annual Meeting of the American Association of School Administrators, Las Vegas, Nevada, February 19-22, 1988.

PRESENTATION OF RICHARD J. DOMBROWSKI
AMERICAN ASSOCIATION OF SCHOOL ADMINISTRATORS
LAS VEGAS, NEVADA FEBRUARY 19, 1988

It is our privilege to share with you a recent experience the Channahon School District went through. An experience that took us from being in debt to operating in the black.

Channahon Illinois is a small rural community, located about 60 miles southwest of Chicago in Will County. The Village of Channahon and District 17 have an approximate population of 4,000, which is composed mostly of blue collar workers and their families. Our District is a kindergarten through eighth grade school district. We have 45 teachers and a student body of 856 currently housed in two separate school buildings. Channahon School District 17 has been in existence since 1839.

We are located in an area advantageous for industry. It is an area which offers transportation across major highways, rail centers, as well as river traffic. Major industry is in the area and is coming to the area. However, large industry with powerful influence, did not feel it should bear its fair share of the tax burden.

In 1983 the financial condition of the School District was bleak. Our major source of revenue was, as is the case of most school districts throughout the country, derived from real estate taxes. Industry, because of its ability to hire high-powered

experts and attorneys of influence within the area, was able to keep assessed valuations far below anything approaching the real value of their property. In 1983 we were operating at a deficit of 1.3 million dollars. Our education fund alone was $988,000 in the red.

In order to offset part of this deficit, we were forced to close one of our school buildings and combine classes and programs into two buildings. We were unable to provide any teacher with raises and we were forced to reduce the size of the teaching, administrative and support staff. We were having difficulty in meeting our bond and interest payments. In short, the situation was desperate. It called for desperate measures.

We were now forced to take on a multi-billion dollar industry as well as a bureaucracy, which was at best neutral, and attorneys who represented that multi-billion dollar industry who were well connected in the county.

Finding the right experts to represent us proved to be a difficult task in and of itself. Most of the experts are hired by major industry throughout the country to represent that industry in keeping assessed valuations low. They do not want to ruffle the feathers of these major corporations by taking on the one-time representation of a small school district such as ours. In

addition, local counsel seemed reluctant to challenge the local power structure, and we were concerned that in a small community it would not be possible to muster a vigorous attack upon a multi-billion dollar giant industry. We therefore hired counsel from outside the county.

In any proceeding, before a board of review or a property tax appeal board, the testimony of the experts is vital. It is also highly specialized and it is necessary to hire both certificated appraisers, as well as individuals who are expert in the particular industry. For example, in our case, we were taking on an oil industry giant and we needed the services of someone who is expert in the construction of oil refineries. We were fortunate in being able to obtain the services of a man who is an expert in the construction and operation of oil refineries. Our expert was James McDonald, a man who had better than 40 years of experience in the oil business and knew every facet of this industry. We also hired attorneys who specialize in the representation of local governmental bodies and who enjoy an excellent reputation throughout our state in their field. We hired Louis Ancel and Ronald Cope of the firm of Ancel, Glink, Diamond, Murphy and Cope, of Chicago.

In order to give you some picture of the enormity of our

undertaking, you must understand that we were dealing with a refinery which our experts valued at approximately $500,000,000. The refinery, at the time we undertook our challenge, was valued by the local assessor at $228,000,000, or an assessed valuation of approximately $76,000,000. As a result of the hearings before the board of review, we were successful in having the assessed valuation increased to $120,000,000. The oil company decided to appeal to the State Property Tax Appeal Board. At that appeal, the taxpayer argued that the market value of the property was $228,000,000. We contended that it was $500,000,000. This meant that the oil company felt that the assessed value of the property should be $76,000,000 and we contended that the assessed value should be $166,000,000. You must understand that arrayed against our small school district were experts from all over the country. These experts consisted of executives from the oil company as well as outside special consultants. The scene was clearly one of David fighting Goliath.

What are the kinds of issues that are raised at these hearings, and why do you need the help of consultants? First the procedures set forth in the statutes for challenging assessed valuations are complex; and then the various methods for determining the assessed valuation of property are also

complex. In Illinois, for example, up until 1984 taxing bodies were not even notified of a change in assessed valuation where a taxpayer had successfully challenged that assessment. Therefore, it is important to make your own inspection of the assessment roles and to make a determination as to whether there have been any major changes in assessed valuations which are going to affect your taxing body. The local taxing body does have the right to initiate a complaint to "increase" an assessment. Many taxing bodies are not aware of this. The first level of review is before a board of review and the hearing there is more informal, but nevertheless, testimony is taken and appraisals are submitted. Following a determination by the board of review, an appeal has to be presented as to the "fair cash value" of the property. This in turn requires consideration of three separate approaches to value. The first method is "comparable sales" or "market data" where the appraiser testifies as to the value of the subject property based upon the known sales prices of comparable properties.

The second method is the "income approach". Under this method a consideration is made as to the value of the property based on the "earning capacity" of the property.

This requires a determination of what is referred to as the capitalization rate, which is the rate of return on an investment in real estate which investors in that type or class of property require as a condition of purchase.

The third approach is the "cost approach" which is the most frequently used for manufacturing or industrial plants. Under this method the current replacement cost or reproduction cost is calculated and then depreciation is determined and deducted from that figure. In our case, all three methods of evaluation were applied to a complex oil refinery located on over 1,200 acres of land. Evidence was presented concerning the oil industry and economic conditions in the oil industry. In determining the reproduction cost, and extremely technical analysis of something called the "Nelson Method" or "Nelson Index" occupied the experts and attorneys in direct and cross examination. Sales of refineries across the country were considered and there was testimony concerning the reasons for those sales in order to determine whether they were, in truth, comparable properties to the subject property. An analysis was made of the refinery's capacity of 200,000 barrels per stream day, and using this evidence opinions were advanced as to the

reproduction cost of the refinery. In order to find a value based on the income approach, it was necessary to determine the net operating income of the refinery and to introduce evidence of a capitalization rate.

What I am saying here is simply to give you some flavor of the kinds of issues that did arise in our case and can arise in your case, and indicate why it is necessary to have the experts who can present the evidence in a meaningful way.

I am happy to tell you that we won, and the property tax appeal board determined that the market value was $500,000,000, which led to an assessed valuation of approximately $166,000,000. This was an incredible victory for a small school district.

As a result of this success, the oil company agreed to negotiate a settlement concerning the assessed valuation which avoided further court litigation and which allowed us to stabilize the assessed valuation for several years into the future.

As a result of our victory and the subsequent agreement, let me show what this has meant financially to our District.

First, look at Chart A, showing fund balances of the District at June 30, 1983 through 1987. If you compare the figures between 1983 and 1987, you will see that our deficit for 1983 was 1.3 million dollars. In contrast, in 1987 we operated with a positive

fund balance of 1.5 million dollars. Turning to Exhibit B, you can see that the revenue generated from residences remained relatively constant. In short, the tax bills of our local homeowners did not increase in any significant way. If we simply had to depend upon residential taxes we would still have been suffering a tremendous shortfall.

In contrast, please look at Exhibit C. Please note that revenues from industry increased from approximately $800,000 in 1982 to 1.5 million in 1985 and leveled off to 1.3 million in 1986. Nothing could be clearer but that this difference in the amount being paid by industry had saved us from disaster. Looking at Exhibit D, you can see that we were operating in 1982 at just below the maximum tax rate and that the rate has remained relatively constant through 1986. We simply could not have picked up additional revenues of any significance by an increase in rates.

Therefore, as a result of the action which we took, industry is now paying its fair share of the real estate tax burden in our district; the tax bills of our local residents have not significantly increased, and we were able to turn around what was otherwise a hopeless situation. We are now able to provide the kind of educational programs for the children of the District

which will allow them to meet the challenges of the future, something which we would otherwise have been unable to do.

While to some of you this may look like a miracle, the fact is that it took ingenuity and six long years of hard work in order to succeed. We were forced into making this choice because local industry was able, through its power and influence, to keep its taxes at the lowest possible level, thereby virtually starving our district. We did not want to fight, but the truth is, we had no choice. It might be argued by some that real estate taxes are an outmoded way of financing the education of our children. I would not disagree with that view. Unfortunately, we who must administer the schools must operate within the legal framework set up by those who pass the laws in our state. We certainly can work to change those laws and make them more enlightened. In the meantime, for those of you who find yourselves short of the necessary finances to provide the programs necessary for the education of your students, you might consider the approach taken by a little school district in Channahon, Illinois.

C H A R T S

CHANNAHON SCHOOL DISTRICT NO. 17
FUND BALANCES AT JUNE 30
1983 THROUGH 1987

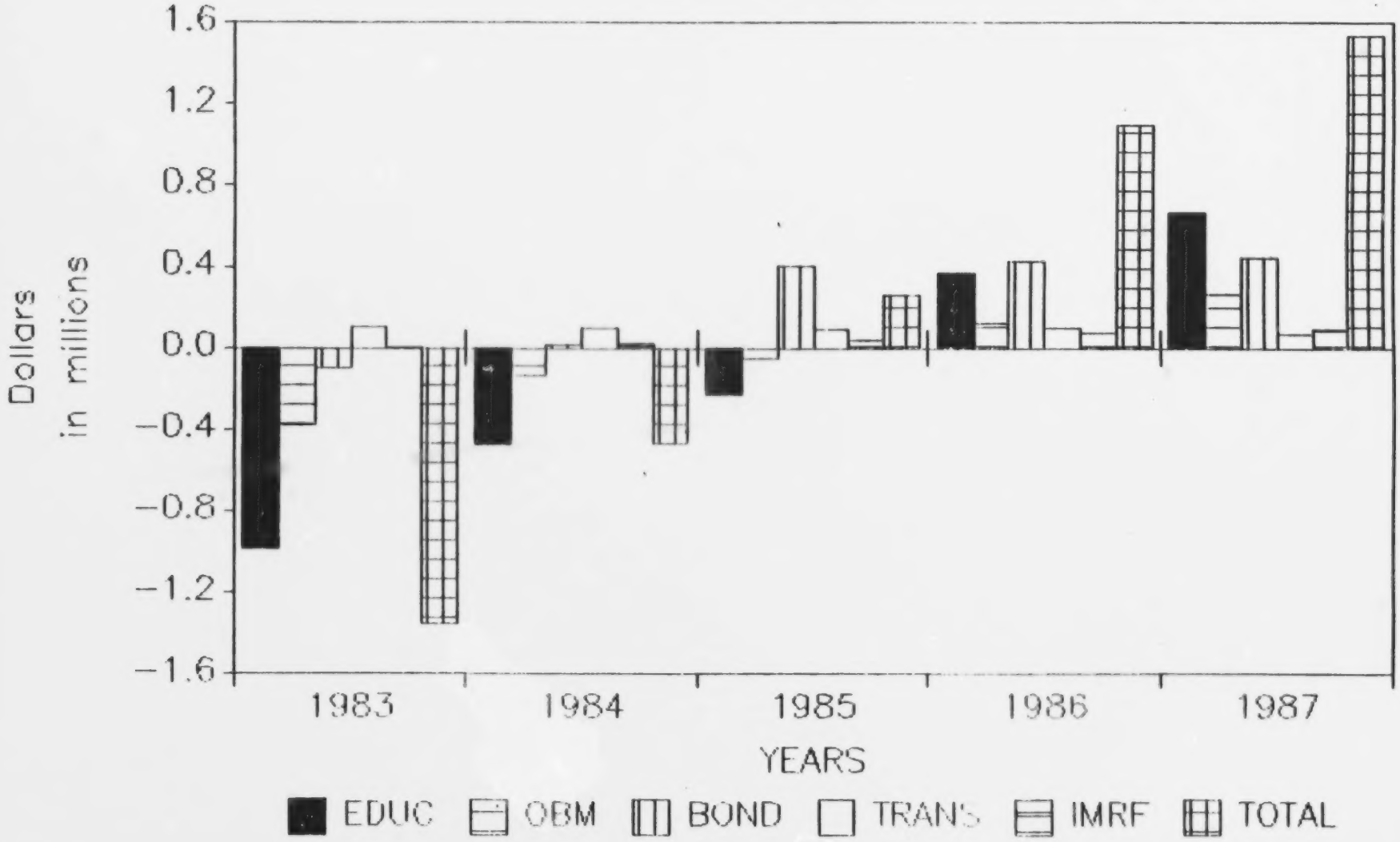

Chart A

CHANNAHON SCHOOL DISTRICT NO. 17
CHANGES IN REVENUE FROM RESIDENTIAL ASSESSED VALUATION

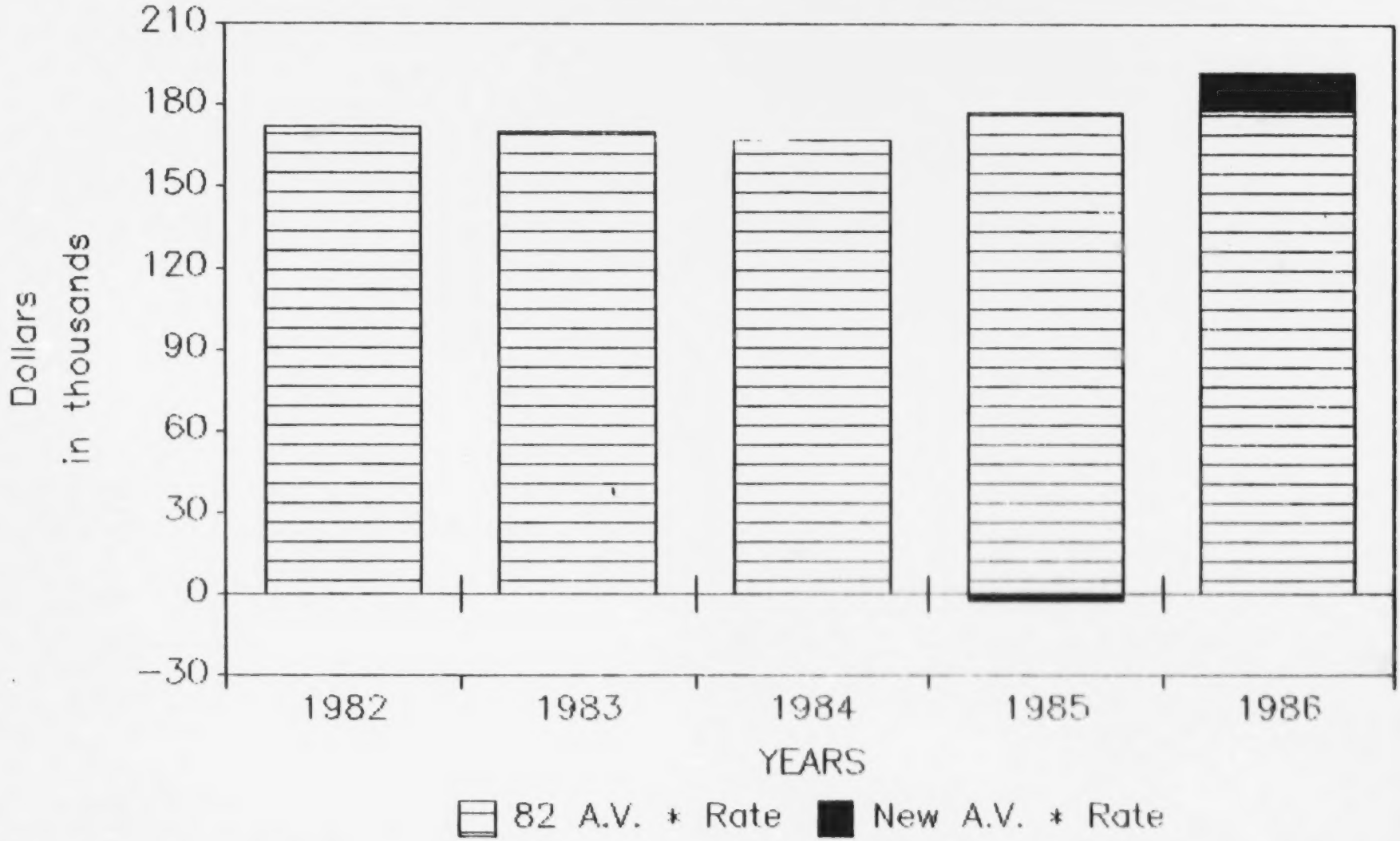

Chart B

CHANNAHON SCHOOL DISTRICT NO. 17
CHANGE IN REVENUE DUE TO CHANGE IN INDUSTRIAL ASSESSED VALUATION

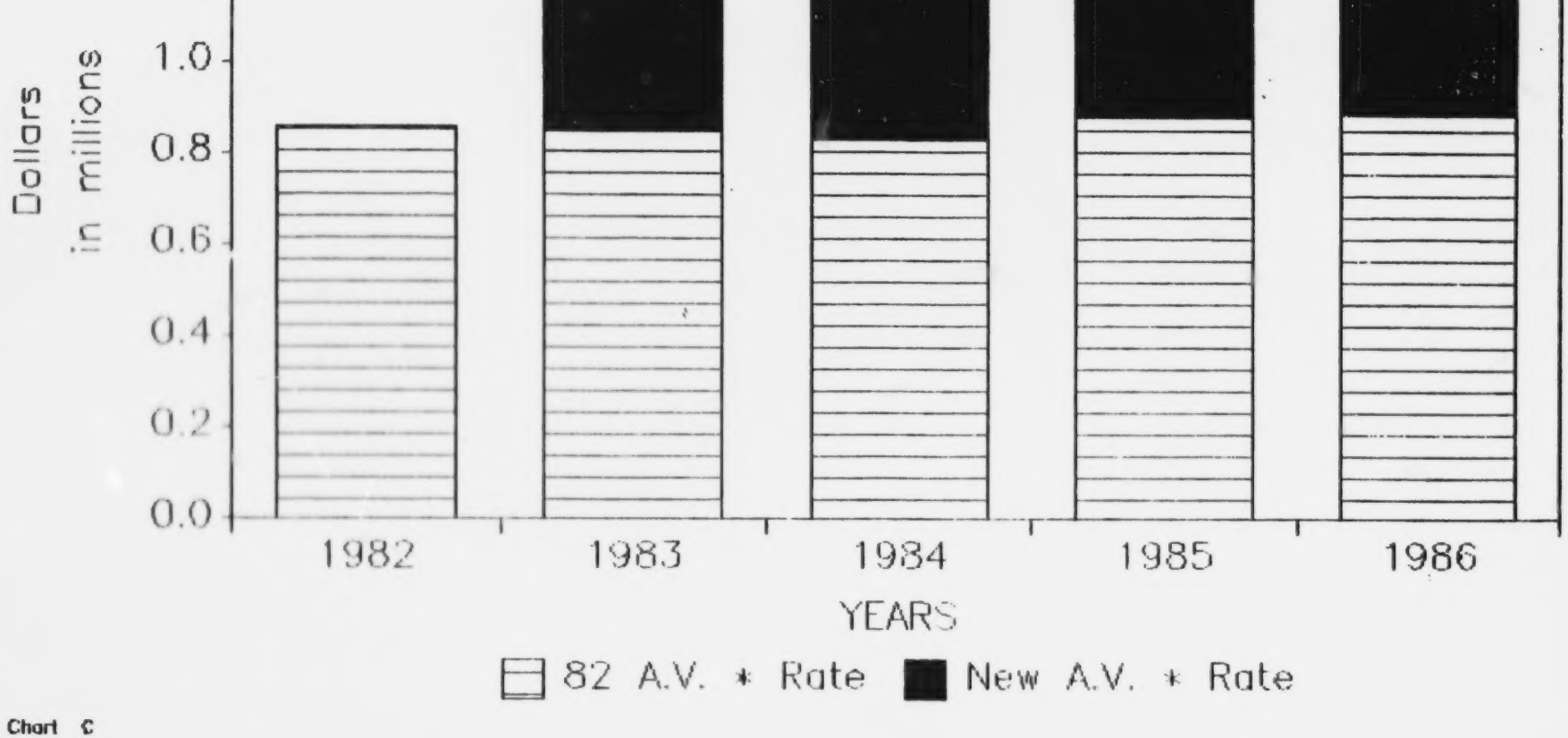

Chart C

CHANNAHON SCHOOL DISTRICT NO. 17
CHANGE IN EDUCATIONAL TAX RATE

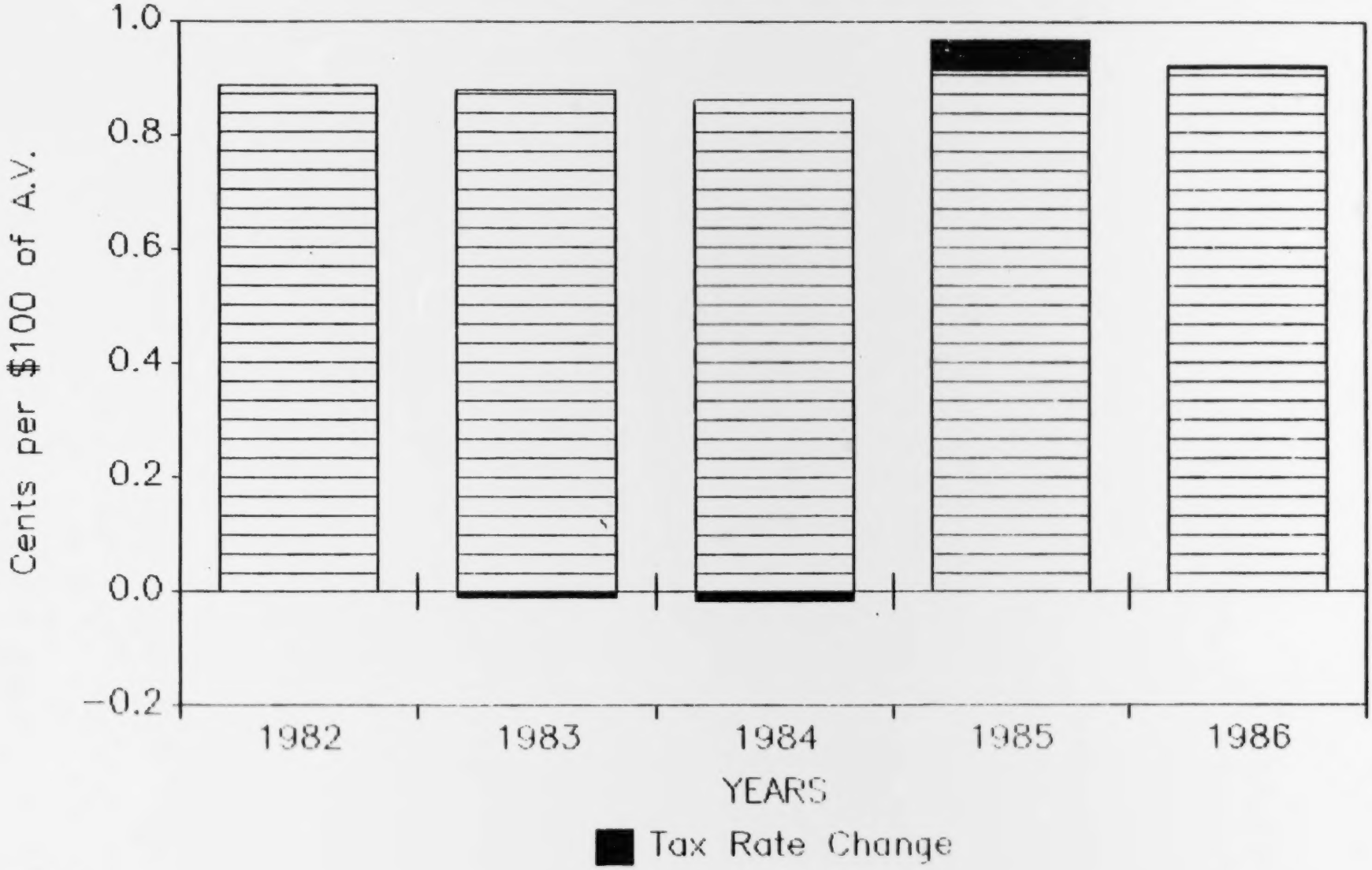

Chart D